

Everyone Needs a Wake-up Call

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Everyone Needs a Wake-up Call

Richard D. Glass

America is a nation of non-savers. The national savings rate hovers slightly above zero. The Employee Benefit Research Institute (EBRI) reports that only one third of the American workforce has ever calculated how much money they will need to retire comfortably.

It comes as no surprise that, according to estimates by Vanguard, the average 401(k) participant contributes of only two-thirds of what he should to his plan.¹ After all, the American worker is a reflection of his culture—a culture of the quick fix, the one-minute manager, and immediate gratification (including living beyond our means).

Further, workers who do want to take the time to develop a systematic retirement investing strategy often find that calculators from different websites give radically different results.

Conventional wisdom maintains that American workers do not want to face up to the fact that they alone bear the responsibility of funding their retirement. While this wisdom has merit, perhaps even greater contributing factors to low savings rates are:

- Plan sponsors are concerned that, if their employees really understood the uncertainty of investing and/or how much they need to contribute, they would demand defined benefit pensions and/or undergo severe morale problems.
- During the latter part of the 1990s, the roaring bull market caused 401(k) plan providers' revenues to greatly exceed their costs, thus minimizing the need to proactively solicit increased participant contributions.
- Almost without exception, providers have not viewed investment education as a profit generating tool. Thus, during bull markets (such as in the 1990s), the value of developing or procuring educational reports, such as gap analyses, isn't appreciated. During bear markets (like today's), providers focus on cutting costs, and new participant reports don't even appear on their radar screens.
- Neither providers nor sponsors want to tell employees that there are no guarantees in investing. The primary challenge of investing is successfully managing risk—in other words, balancing the need to avoid losses against the need for long-term growth—so an adequate nest egg can be accumulated by making predictable and acceptable contributions.

If gap analyses are periodically distributed, participants can compare the current report to past ones. Such comparisons will clearly demonstrate to participants the fragility of the assumptions underlying the planning process and the difficulty of achieving retirement security. Such realizations, providers worry, will eventually cause participants to panic, resulting in a flood of money leaving profitable stock funds for fixed income funds with much lower fees (further cutting profit margins during tough business conditions).

At first glance, it might appear that providers and sponsors have acted in their own best interests by not providing gap analyses and other educational reports. Unfortunately that conclusion is way off the mark. The absence of such reports is just one indication of a much larger problem, namely, the desire of providers to deal with participants through the cheapest means available—the Internet.

¹ *How America Saves*, Vanguard, 2000, p. 20.

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In the quest to maximize profits by using technology to cut costs, providers have discouraged, perhaps even prevented, participants from developing relationships with them. The fact that most 401(k) providers are disappointed in their ability to capture rollover IRAs when employees retire or change jobs clearly demonstrates this lack of a relationship.

When the market was going gang busters, participants thought they were geniuses—or at least they believed their retirement planning was under control. (Remember, it was reported that investors thought the stock market, over the long-term, would generate an average annual growth rate of over 20%.) Another study found that many 401(k) participants thought that they were well on the road to financial security but that their peers would come up short. Amazingly, participants reached these conclusions even though few of them had calculated their retirement needs or how much they should be contributing.

However, the irrational exuberance of the 90s, followed by the dot-com bust, and, now, the absence of a well-defined recovery (perhaps even a continued market decline), have sufficiently shaken the confidence of 401(k) participants (as well as other investors). As a result, these participants are seeking professional help.

They are finding help in financial advisors who are willing to communicate with them whenever and however they wish. Conditioned by these professionals to expect total financial planning and a lot of handholding, participants find 401(k) providers who offer relatively limited guidance and/or education, want to communicate solely via the Internet, and maybe even pawn them off to third party Internet-based advisory services unpalatable.

Nay-sayers would argue that most 401(k) providers face a dismal future. However, the future can be very bright for organizations that are willing to be proactive in both gathering and retaining assets. After all, participants do know their provider—they open the mail their provider sends (quarterly statements, if nothing else), and they call their provider (if the provider has a call center) when they have questions about their accounts. These interactions offer phenomenal opportunities to turn participants into clients for providers who act to take advantage of them.

The pathway to successful relationship building is that of a contrarian who ignores conventional wisdom. Does that make sense? Of course it does. Just look at the successes of Fidelity and Vanguard. Fidelity invested in technology because it made sense to do so, not because someone else had paved the way. Fidelity also invested heavily in website design and content (including a guidance tool) while their competition was only thinking about it. What Fidelity does not do is refer participants to third party Internet-based advisory services.

Vanguard commits what most money managers consider cardinal sins. This fund company argues active management usually doesn't add value and investors should use low cost index funds. In addition, Vanguard keeps their 401(k) recordkeeping fees low. As a result, the company has grown into both an investment and a 401(k) powerhouse.

The following contrarian suggestions are key ingredients in the recipe of successful relationship building. Providers who implement these steps are likely to reap a profitable reward.

- Periodically give participants a printed personalized gap analysis so they can see where they are along the road to retirement security. Provide and encourage them to use a gap analysis calculator on your website so they can further tailor the analysis to their own unique situations.

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- Provide a variety of web-based financial calculators (i.e., mortgage calculator, college savings calculator, etc.). The amount a participant invests for retirement is not decided in isolation. Unfortunately few 401(k) providers recognize this fact.

The table below clearly shows the funding demands faced by a 35 year old starting to fund both his retirement and his newborn's education at a private college. As you can see, a little more than 20% of his pre-tax income is required to fund these two obligations. The funding requirement for either goal alone is about 10% of his gross income.

Funding Demands*

Annual gross income	\$60,000
Required annual investment	\$12,300
Retirement: \$5,900	
Child's education: \$6,400	
Required annual investment as a percentage of gross income	20.5%

- Make arriving at an asset allocation easy for participants. Provide them with prepackaged portfolios (e.g., lifestyle or lifecycle funds) and charts that show the historical performances of each allocation.
- Allow each participant to delve into the asset allocation process to the extent that she wishes. For example, provide modeling software that allows participants to either quickly select a prepackaged fund or interactively create and model their own hypothetical asset allocations.
- Encourage participants to seek help from your typical call center. If participants don't talk to your representatives, they will talk to another organization's. It is as simple as that. E-mail is not a comfortable means of communicating about investing for participants who don't understand the subject and feel they have "been taken to the cleaners" over the last three years.
- Insurance company and bank providers should consider going beyond call centers. They should train some agents and/or trust officers to be knowledgeable professionals to whom participant inquiries can be channeled.

Charles Schwab offers to help investors by providing salaried employees to assist them or referring them to independent advisors (who will place the business through Schwab). Fidelity advertises their willingness to meet with prospects and clients anytime and anywhere. Merrill Lynch is introducing one stop shopping via *Total Merrill*. These firms understand what is involved in relationship building. Does your organization?

*The following assumptions were used in calculating this table: current age: 35; retirement age: 67; current salary: \$60,000; salary growth rate: 3%; replacement ratio: 80%; post-retirement inflation rate: 3%; current account balance: \$0; Social Security benefit at retirement \$81,000; annual post-retirement Social Security COLA: 3%; post-retirement life expectancy: 25 years; investment return: 7%; current annual college tuition: \$30,000; annual tuition increase: 4%; the child attends college for four years starting at age 18.

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The key to success is a well-defined value proposition for the ultimate end-user, the participant. By definition, this means you can't appear to be a clone of a more powerful competitor. Unfortunately, a herd mentality has pervaded the 401(k) industry, and the copycats are losing both battles: they are neither capturing nor retaining assets.